87-1261

No. .....

In The
Supreme Court of the United States
October Term, 1987

Bill Honig, Superintendent of Public Instruction for the State of California, the State of California, a Sovereign State, by and through the California Department of Education, a state agency, and Hayward Unified School District, a state agency,

Petitioners,

v.

William J. Bennett, in his capacity as Secretary of the United States Department of Education,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

1. Whether the Secretary of Education is entitled to prejudgment interest on misspent federal education grant funds prior to judicial review of the underlying audit exception and in the absence of any Congressional authorization for such interest.

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In The

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Bill Honig, Superintendent of Public Instruction for the State of California, the State of California, a Sovereign State, by and through the California Department of Education, a state agency, and Hayward Unified School District, a state agency,

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v.

William J. Bennett, in his capacity as Secretary of the United States Department of Education,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners, Bill Honig, the Superintendent of Public Instruction for the State of California,[1] the State of California, the California Department of Education, and the Hayward Unified School District, respectfully request this Court to issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on November 2, 1987.

1. In the courts below this action was prosecuted in the name of the former Superintendent of Public Instruction, Wilson Riles. The current Superintendent, Bill Honig, should be substituted pursuant to F.R.C.P. Rule 25(d).

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 831 F.2d 875, and appears in the Appendix hereto, App. 1-9.

The Judgment and Order of the District Court for the Eastern District of California was filed on September 3, 1985. That decision is not reported and appears in the Appendix hereto, App. 10-13.

JURISDICTION

The judgment of the Court of Appeals was entered on November 2, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

20 U.S.C. Section 1226a-1 provides:

> "Payments pursuant to grants or contracts under any applicable program may be made in installments, and in advance or by way of reimbursement, with necessary adjustments of overpayments or underpayments, as the Secretary may determine."

STATEMENT OF THE CASE

Title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. § 241 et seq.) provided for federal grants for state programs designed to meet the needs of educationally disadvantaged children who lived in areas

with high concentrations of low income families. During fiscal years 1970-71 and 1972-73, the predecessor to the current Secretary of Education ("the Secretary") allocated Title I funds to the California Department of Education ("the Department"). The Department in turn allocated some of those funds to the Hayward Unified School District ("school district") which had made application to the Department for such funds for use in local educational programs.

In November 1972, after all the approved Title I funds for the 1970 and 1971 school years had been expended, the Secretary commenced an audit of the Title I program operations and expenditures by the school district.

In January 1975 the federal audit report was issued, finding that the school district had misspent $188,140 in Title I funds during the fiscal years in question. The auditors found that the school district had failed to document adequately that its Title I expenditures for librarians, school nurses and warehousemen were used solely for eligible students.

The Department pursued an administrative appeal to the Title I Audit Hearing Board which upheld $108,701 of the alleged misexpenditure. On September 1, 1978, the Secretary upheld the hearing board's decision.

On October 31, 1978, the Department filed an appeal of the Secretary's decision in the Court of Appeals for the Ninth Circuit pursuant to provisions in the 1978 amendments to Title I, Pub. L. 95-561, 89 Stat 2196 et seq. On November 1, 1979, the Ninth Circuit summarily dismissed the appeal for lack of jurisdiction because the subject

amendments had not yet become effective when the appeal was filed.[2]

Thereafter, the parties engaged in oral and written communications concerning the Secretary's demand for repayment of the funds and the Department's contention that the funds had not been misspent.

On March 17, 1981, the Secretary sent a written demand for repayment which included a statement that if the Department did not satisfy the debt within 30 days, interest would begin to accrue. On September 10, 1982, the Department received a letter from the Secretary in which the Secretary threatened to offset the contested funds plus accrued interest from current Title I funding due the Department.

On November 8, 1982, the Department commenced the instant action in the district court for judicial review of the Secretary's decision. Subsequently the district court granted partial summary judgment in favor of the Secretary, concluding that the Department's request for judicial review was untimely but reserving the issue of prejudgment interest for later resolution.

Eventually the trial court entered final judgment denying such interest. (App. 12) The Secretary appealed, and on November 2, 1987, the Court of Appeals reversed the judgment.

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2. The district court below later concluded that the Department's initial erroneous appeal to the Ninth Circuit was taken in "good faith". (App. 12-13)

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REASONS FOR GRANTING THE WRIT

I

THE DECISION BELOW CONFLICTS WITH PRIOR DECISIONS OF THIS COURT ON THE COMMON LAW RIGHT TO PREJUDGMENT INTEREST

The parties agree that the issue of the Secretary's entitlement to prejudgment interest must be decided on the basis of federal common law, there being no statutory basis for such a claim in the context of Title I grants.[3]

This Court's pronouncements on the subject of whether the federal government may charge interest on debts owed by the states have been few. Last term, however, the Court addressed the issue in *West Virginia v. United States*, — U.S. —, 107 S.Ct. 702 (1987). There this Court held that as a matter of federal common law, the federal government is entitled to prejudgment interest on a debt owed by a state "in any ordinary commercial contractual arrangement between a State and the Federal Government." *West Virginia, supra*, 107 S.Ct. at p. 706. The transaction at issue in *West Virginia* involved an agreement between the Corps of Engineers and state officials to prepare mobile home sites for flood victims. Under the federal Disaster Relief Act, site preparation was clearly

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3. Indeed, in the arena of federal grant programs, Congress knows how to provide for interest on disallowances when it wants to do so. See, e.g., 42 U.S.C. § 1396b(d)(5) which requires the Secretary of Health and Human Services to offset from a state's future allocations under the Medicaid program, any previous misexpenditures *plus interest* from the date of the initial disallowance to the date of the final administrative determination.

the duty of the state government, although the mobile homes themselves were supplied by the federal government. When West Virginia refused to pay for the work performed, the Corps sued for breach of contract.

This Court concluded that whether prejudgment interest will be awarded the federal government as against a state depends upon a consideration of the interests of the respective governments involved. *West Virginia v. United States, supra,* 107 S.Ct. at p. 706, relying on *Board of Commissioners of Jackson County v. United States,* 308 U.S. 343, 350 (1939). This Court went on to determine that in the context of West Virginia's "ordinary commercial arrangement" with the Corps of Engineers, the federal government's interest in complete compensation outweighed the sole interest asserted by West Virginia of "not paying more than it has to." *Id.* at p. —.

Nonetheless, this Court clearly limited its holding in *West Virginia* to the type of intergovernmental arrangement at issue there.

> "Accordingly, we hold that West Virginia may *under the circumstances of this case* be held liable for prejudgment interest. [footnote omitted]" *West Virginia, supra,* 107 S.Ct. at p. 707; emphasis added.

In the instant proceeding, the Court of Appeals unreasonably expanded the narrow holding in *West Virginia* to a federal educational grant program that implements Congressional policy to involve "multiple levels of government in a cooperative effort to use federal funds to support compensatory education for disadvantaged children." *Bennett v. Kentucky Department of Education,* 470 U.S. 656, 669 (1985). Such an extension is not warranted.

The Department's interests herein are not limited to "not paying more than it has to," but they include its continuing responsibility to provide educational services to disadvantaged children in California's schools. Because the school district has long since spent the funds in question on educational services (albeit without adequate accounting controls to show that they were limited to Title I-eligible students), requiring the Department to pay prejudgment interest on those funds necessarily impairs the Department's ability to serve such students in the present.

More fundamentally, the cooperative nature of the educational program at issue here, which of its very nature deals in intangibles, requires a different approach to the subject of prejudgment interest on misspent funds than does an arms-length contract involving bricks and mortar or rocks and soil.

II

THE DECISION BELOW DECIDES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, RESOLVED BY THIS COURT.

This Court has never addressed the issue of a common law entitlement to prejudgment interest on allegedly misspent federal grant funds. Moreover, no Circuit Court of Appeals, other than the Ninth Circuit below, has addressed this issue.[4]

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4. Three Courts of Appeals have addressed the issue of whether the Debt Collection Act, 31 U.S.C. § 3701 *et seq.*, pre-

(Continued on following page)

In reversing the judgment of the district court, the Ninth Circuit extended this Court's decision in *Bell v. New Jersey*, 461 U.S. 773 (1983) to include prejudgment interest as a remedy for misexpenditure of federal grant funds. Although this Court in *Bell* did decide that the Secretary had a statutory right to demand repayment of misspent Title I grant funds from New Jersey, resolution of the issue turned on whether the express pronouncements of Congress established such a right. *Bell v. New Jersey, supra*, 461 U.S. 783-4.

At issue in *Bell* was virtually the same statutory language which the Secretary here concedes does not authorize him to collect prejudgment interest, Section 207(a)(1) of the Elementary and Secondary Education Act of 1965, the predecessor to current 20 U.S.C. § 1226a-1. There this Court read language allowing the federal government to adjust future payments to the states in light of past payments which were greater or less than they should have been, as providing the Secretary with the right to demand repayment of misspent funds. *Bell, ibid.* It was principally for this reason that this Court rejected New Jersey's

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cludes the collection of prejudgment interest from the states on misspent federal grant funds. *Perales v. United States*, 751 F.2d 95 (2d Cir. 1984); *Commonwealth of Pennsylvania v. United States*, 781 F.2d 334 (3d Cir. 1986); and *Arkansas v. Block*, 825 F.2d 1254 (8th Cir. 1987). In all three cases, the courts have held that the Debt Collection Act precludes collection of such interest from the states. The Debt Collection Act has no application to the case at bar because the grants in question were made prior to October 25, 1982, the operative date of the Act. Nonetheless, this Court has not yet addressed the availability of prejudgment interest in federal grant programs either under the Debt Collection Act or prior to its enactment.

argument that *Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1, 17 (1981) [Congress must act "unambiguously" when imposing a condition on a federal grant], dictated a different result. *Bell*, *supra*, 461 U.S. at p. 790, n. 17.

Petitioners acknowledge that this Court in the subject footnote 17 in *Bell* also distinguished *Pennhurst* on the ground that what was at issue in *Bell* was a remedy for a state's noncompliance with grant conditions rather than establishment of a new condition on the grant itself. Imposition of interest, however, involves more than mere collection of an overpayment but includes something in the nature of a penalty.

Indeed the district court below correctly recognized that the Secretary's claim for prejudgment interest was a new condition of financial liability which could not be implied in a federal grant program in the absence of express Congressional provision, citing both *Bell* and *Pennhurst* in this regard. (App. 12)

III

THE COURT OF APPEALS' DECISION WILL HAVE SUBSTANTIAL ADVERSE IMPACT ON OTHER FEDERAL-STATE GRANT PROGRAMS

Although the amount of principal, and consequently the amount of interest, involved in the present controversy is not particularly large, the impact of the Court of Appeals' decision in this case on other pending federal audits involving grants made prior to October 25, 1982, the effective date of the Debt Collection Act, 31 U.S.C. § 3701 et seq., § 3717(g)(2), is considerable.

Pending federal audit cases involving grants to the California Department of Education alone represent principal amounts in the range of twenty million dollars with over $845,000 worth of accrued prejudgment interest to date. The decision's impact on federal audits involving other California government agencies should also be considered. Some other federal grant programs, like Title I, do not have express Congressional authority to recover prejudgment interest on allegedly misspent federal funds. The decision below stands as authority for collection of interest in these cases as well.

Add to this the impact on the governments of all the other states both in the area of Title I grants and other educational grant programs as well as in other grant programs, and the impact of the Ninth Circuit's decision is likely calculated in the tens of millions of dollars.

———o———

CONCLUSION

For the foregoing reasons, this Court should issue a Writ of Certiorari to review the decision of the Ninth Circuit Court of Appeals in this matter.

Respectfully submitted,

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CHARLTON G. HOLLAND, III
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APPENDIX 1

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WILSON RILES, in his capacity as Superintendent of Public Instruction of the State of California; THE STATE OF CALIFORNIA, a Sovereign State, by and through the CALIFORNIA STATE DEPARTMENT OF EDUCATION, a State Agency, HAYWARD UNIFIED SCHOOL DISTRICT, a State Agency, *Plaintiffs-Appellees,*	No. 85-2749 D.C. No. CIV-S-82-848 EJB
v.	OPINION
WILLIAM J. BENNETT, in his capacity as Secretary of the United States Department of Education, *Defendant-Appellant.*	

Argued and Submitted
October 6, 1987—San Francisco, California

Filed November 2, 1987

Before:
James R. Browning, Chief Judge, Harry Pregerson and Stephen Reinhardt, Circuit Judges.

Per Curiam

Appeal from the United States District Court
for the Eastern District of California
Edward J. Garcia, District Judge, Presiding

SUMMARY

Remedies/Education and Schools

Appeal from judgment. Reversed and remanded.

Appellant Secretary determined that appellee California had not adhered to the applicable conditions in spending Title I funds and demanded repayment. The State filed a complaint challenging the Secretary's determination. The district court granted the Secretary's motion for summary judgment holding that the State owed the money but denied prejudgment interest. This case was held awaiting *West Virginia*. It reaffirmed that parties owing debts to the federal government must pay prejudgment interest where the underlying claim is a contractual obligation. The State claims that the underlying claim is not contractual but rather reflects Congress' judgment. The Secretary concedes that Congress' purposes must be considered and argues that *West Virginia* requires an award of prejudgment interest unless state policy *compels* any deviation. Only an award of prejudgment interest will fully compensate the United States for the funds wrongfully withheld by the State. Such an award will serve the purpose of Congress reflected in Title I. The interests of the State in avoiding such interest are minimal.

[1] The State argues that *Pennhurst* bars the recovery of prejudgment interest because Congress has not provided "unambiguously" for the collection of interest on missapplied Title I grants. [2] However, a subsequent decision shows that the case is not applicable to the State's liability for prejudgment interest. [3] Prejudgment in-

terest is part of the remedies available against a non-complying State, rather than an additional condition to the grant.

COUNSEL

Robert K. Rasmussen, Washington, D.C., for the defendant-appellant.

Peter G. DeMauro and Dennis Eckhart, Sacramento, California, for the plaintiffs-appellees.

OPINION

PER CURIAM:

The Secretary of the United States Department of Education appeals the denial of prejudgment interest on an award of $108,701 for Title I grants misspent by the State of California. The district court denied interest because it read *Pennhurst State School and Hosp. v. Halderman,* 451 U.S. 1 (1981), as requiring explicit statutory authorization for an interest award. We reverse and remand.

I

Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. § 241(a) *et seq.*, provided for grants to states to improve education for disadvantaged children conditioned on compliance with various statutory and regulatory requirements.[1] Title I funds not spent on complying programs must be repaid.

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[1]The Title I statute subsequently was amended and reorganized in the Education Amendments of 1978. *See* Pub. L. No. 95-561, 20 U.S.C. § 2701 *et seq.* As of July 1, 1982, the Title I program was superseded by Chapter 1 of the Education Consolidation and Improvement Act of 1981. *See* Pub. L. No. 97-35, 20 U.S.C. § 3801 *et seq.*

The Secretary determined that California had not adhered to the applicable conditions in spending funds granted for use by the Hayward Unified School District between 1970 and 1972. The administrative process within the Department concluded in 1978 with a determination by the Secretary of Education that the State had misspent $108,701. The State filed a petition for review in this court which was dismissed for lack of juridiction. The State did not file a petition in what was then the proper forum, a United States District Court. *See Bell v. New Jersey,* 461 U.S. 773, 777 n.3 (1983).[2]

On March 17, 1981, the Secretary demanded repayment, stating interest would be charged if payment was not received in 30 days. The State did not respond. A second demand letter was also ignored. The Secretary threatened to offset the debt against current-year grant funds. The State then filed a complaint for injunctive and declaratory relief challenging the Secretary's determination. The Secretary counterclaimed for the amount of the misspent funds, plus interest from April 16, 1981.

The district court granted the Secretary's motion for summary judgment on the merits, holding that the administrative decision that the State owed $108,701 was final and irrevocable, but denied prejudgment interest. The Secretary appealed; the State did not.

We held this case awaiting *West Virginia v. United States,* 107 S. Ct. 702 (1987). In the *West Virginia* decision, the Supreme Court reaffirmed "the longstanding

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[2]Congress subsequently changed the forum for review to the Courts of Appeals. *Id.*

rule that parties owing debts to the Federal Government must pay prejudgment interest where the underlying claim is a contractual obligation to pay money." 107 S. Ct. at 706 (citation omitted).

The State emphasizes the fact that the underlying claim in this case is not an "ordinary commercial contractual arrangement," *id.*, but rather arises from a federal grant program reflecting "the judgment of Congress concerning desirable public policy," and intervening "multiple levels of government in a cooperative effort to use federal funds to support compensatory education for disadvantaged children." *Bennett v. Kentucky Dep't of Educ.*, 470 U.S. 656, 669 (1985). The State appears to derive no more from this fact than that the effect upon the realization of Congress' purposes must be considered in determining whether an award of prejudgment interest is appropriate. This much is conceded by the Secretary, and clearly required by the statement in *West Virginia* that "before applying the usual rule regarding prejudgment interest as against a private party to a State, a federal court should consider the interests of the two governments involved." 107 S. Ct. at 706 (citation omitted).

The Secretary goes further, however, arguing that *West Virginia* requires an award of prejudgment interest unless "state policy *compels* any deviation" from the general rule allowing such interest on debts due the United States. *Id.* (emphasis added). We need not decide whether the balance should be weighted in favor of the allowance of interest as the Secretary argues. We are satisfied that an even-handed balancing of state and federal interests required such an allowance in this case.

The federal interests supporting the collection of prejudgment interest are important ones. Only an award of prejudgment interest will fully compensate the United States for the funds wrongfully withheld by the State. *Id.* Such an award will serve the purposes of Congress reflected in Title I by insuring that moneys appropriated for use under Title I are devoted to service of the intended beneficiaries—disadvantaged children—rather than to the relief of California state taxpayers.

The State argues that "[s]uch a rule would tend to discourage states from participating in federal grant programs, since the states would be subjecting themselves to a tremendous risk in accepting funds." The State's argument assumes that a state deciding whether to accept a grant under Title I will consider itself likely to violate the grant's terms. There is no support for such an assumption. There is no evidence that such violations of grant conditions under Title I are frequent or that the sums involved are significant in relation to the very large amounts available to the states under Title I.[3]

In contrast to the substantial federal interests in receiving prejudgment interest, the interests of the State in avoiding such interest are minimal. The Supreme Court rejected as irrelevant the interest any state may have "in not paying any more than it has to." *West Virginia*, 107

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[3]Title I was the largest federal elementary and secondary education funding program. (Appellant's Opening Brief at 11 n.6.) As noted in *Bennett v. Kentucky*, 470 U.S. at 667: "Title I grew from an annual appropriation of $959 million in 1966 to more than $3 billion by 1981, and assisted compensatory education programs in every State and in more than 14,000 school districts."

S. Ct. at 707. The State's contention that it acted "in good faith" reflects no state interest that would be served by avoiding payment of prejudgment interest. Moreover, the State is not without fault. The Secretary seeks interest only from the date of the demand letter sent two-and-one-half years after the Secretary's determination of the amount due. The State did nothing to pay the debt, or to challenge it, until the Secretary threatened to offset the debt from current-year appropriations.

II

Pennhurst does not bar prejudgment interest in this case.

Pennhurst held that "if Congress intends to impose a condition on the grant of federal monies, it must do so unambiguously." 451 U.S. at 17 (footnote omitted). The Court reasoned as follows:

> [L]egislation enacted pursuant to the spending power is much in the nature of a contract in return for federal funds, the States agree to comply with federally imposed conditions. The legitimacy of Congress' power to legislate under the spending power thus rests on whether the State voluntarily and knowingly accepts the terms of the "contract." . . . There can, of course, be no knowing acceptance if a State is unaware of the conditions or is unable to ascertain what is expected of it.
>
> *Id.* (citations omitted).

[1] The State argues that *Pennhurst* bars the recovery of prejudgment interest because Congress has not provided "unambiguously," or indeed at all, for the collection of interest on Title I grants misapplied by a state.

[2] It is clear from the Supreme Court's subsequent decision in *Bell v. New Jersey*, 461 U.S. 773 (1983) that *Pennhurst* is not applicable to the State's liability for prejudgment interest. *Bell v. New Jersey* held that states could be required to repay the Secretary for misspent Title I funds. New Jersey argued that *Pennhurst* required that Congress state "unambiguously" that a state was obligated to repay misspent funds, and the statute contained no such statement. The Court held *Pennhurst* inapplicable:

> *Pennhurst* arose in the context of imposing an unexpected condition for compliance—a new obligation for participating States—while here our concern is with the remedies available against a noncomplying State.
>
> 461 U.S. at 790 n.17.

Our decision in *California Tribal Chairman's Ass'n v. United States Dept. of Labor*, 730 F.2d 1289, 1291-92 (9th Cir. 1984) is to the same effect.

[3] Since prejudgment interest is part of "the remedies available against a noncomplying State," rather than an additional condition to the grant. *Bell v. New Jersey* and *California Tribal* are dispositive of this case.

Perales v. United States, 751 F.2d 95 (2d Cir. 1984), *aff'g* 598 F.Supp. 19 (S.D.N.Y.), and *Arkansas v. Block*, 825 F.2d 1254, 1258 n.7 (8th Cir. 1987), relied upon by the State, appear to be distinguishable,[4] but in any event our

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[4]The Supreme Court has emphasized that decisions to award or deny interest on statutory obligations rest on "an

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decision here is controlled by the Supreme Court's reading of *Pennhurst* in *Bell v. New Jersey*, followed by this court in *California Tribal*.

III

The State conceded at oral argument that the Debt Collection Act, 31 U.S.C. § 3701 *et seq.*, is inapplicable since the Act does not apply to a claim under a contract executed before October 25, 1982, 31 U.S.C. § 3717(g)(2). *See West Virginia*, 107 S.Ct. at 707 n.6.

The summary judgment against the Secretary is reversed and the case remanded to the district court to determine the prejudgment interest owed by the State.

(Continued from previous page)

appraisal of the congressional purpose in imposing them . . ." *Rodgers v. United States*, 332 U.S. 371, 373 (1947). *Perales* relies heavily on the provisions of the Food Stamp Act, especially those limiting the federal agency's right to collect losses before appeals are exhausted. *See* 598 F.Supp. at 24-26. In *Perales* and *Arkansas* the federal agency sought to impose interest only 30 days after the state had been notified that funds had been misspent, and before administrative appeals had been exhausted. Here, no effort was made to collect interest for the period during which the administrative process was being pursued. Indeed, the Secretary did not seek interest for two-and-one-half years after notice of the final determination. The results in *Perales* and *Arkansas* are better understood as applications of the common law balancing test where federal interests were outweighed by those of the state.

APPENDIX 2

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

WILSON RILES, in his capacity as Superintendent of Public Instruction of the State of California; THE STATE OF CALIFORNIA, a Sovereign State, by and through the CALIFORNIA STATE DEPARTMENT OF EDUCATION, a State Agency, HAYWARD UNIFIED SCHOOL DISTRICT, a State Agency,

Plaintiffs,

v.

WILLIAM J. BENNETT, in his capacity as Secretary of the United States Department of Education,

Defendant.

CIV. NO. S-82-848 EJG

/

JUDGMENT AND ORDER

(Filed September 3, 1985)

This cause came before this court on plaintiffs' complaint and first amended complaint wherein plaintiffs challenged the validity of the administrative offset proposed by the United States Department of Education (ED). The offset was based upon the 1978 final administrative decision of the United States Commissioner of Education (Commissioner), which determined that plaintiffs had misspent $108,701 under the applicable statutory and regulatory provisions of Title I of the Elementary and Secondary Education Act of 1965 (ESEA), as amended, 20 U.S.C. section 241a *et seq.* (1976). This cause also came before this court on defendant's counterclaim against plaintiffs

wherein the Secretary of ED asserted his common law and statutory authority to recover the $108,701 in funds misspent by plaintiffs under ESEA. The Secretary urged this Court to uphold the common law and statutory validity of the proposed administrative offset of plaintiffs' debt, established by the 1978 final administrative decision of the Commissioner. The Secretary sought judgment on defendant's counterclaim for $108,701 plus interest accruing from April 1981 to the date of judgment. On February 8, 1985 this court granted partial summary judgment in favor of defendant and held that the administrative decision by defendant was final and unreviewable. This case is now before the court on defendant's second motion for summary judgment, pursaunt to Rule 56 of the Federal Rules of Civil Procedure, to resolve the remaining issues of interest and the grantback. The court having considered all the pleadings in this action, and having found that there are no genuine issues of fact that remain in dispute, and having concluded that defendant is entitled to judgment as a matter of law, this court concludes:

That the administrative decision of the United States Commissioner of Education (Commissioner) is final and unreviewable; that accordingly plaintiffs are bound by the findings of fact and conclusions of law contained in that decision which held that plaintiffs had misspent $108,701 under Title I of ESEA, as amended, and that ED has the common law and statutory authority under ESEA and section 415 of the General Education Provisions Act (GEPA), 20 U.S.C. section 1226a-1, to recover plainitffs' debt by administrative offset against current grant funds; and that for these and the other reasons stated by the court at the February 8, 1985 hearing, defendant's motion for summary judgment is granted.

Further, this court finds that defendant may not recover prejudgment interest against plaintiffs—because there is a constitutional prohibition against implying financial liabilities by a state which are not expressly set forth by Congress and approved by the states. (*Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1 (1981).) Further, there is no provision in Title I of ESEA for awarding interest against a state on its Title I debt and *Bell v. New Jersey*, 108 S.Ct. 2187 (1983), holds that the United States cannot imply additional terms in a grant program to which a state has not consented. Prejudgment interest would be such an additional term. Therefore, prejudgment interest as requested by ED is denied.

Finally, the court finds that the doctrine of the futility in exhausting administrative remedies applies to the question of whether any possible grantback claim is timebarred. *Lopez v. Heckler*, 725 F.2d 1489, 1500 (9th Cir.), *vacated and remanded*, 105 S.Ct. 583 (1984). Defendant contends that any possible grantback is now timebarred. Plaintiff contends that its good faith efforts to litigate the question of a grantback should toll the running of the time period for requesting a grantback. Defendant responds that plaintiff has not exhausted administrative remedies on the issue and therefore this court cannot decide the timebar issue. However, defendant's position that a grantback is timebarred is clear, final and unyielding. Therefore, further administrative appeals on that question would serve no useful purpose. The court finds that plaintiffs' attempt to seek review in the Appellate Court was a result of a good faith but erroneous effort to follow then recent changes in the structure of judicial review. Therefore, the time limitation applicable

to the grantback provision of 20 U.S.C. section 1234(e) was tolled during all judicial review proceedings relative to the matters herein. The remaining issues as to any possible grantback have not been considered by the defendant administrative agency and the court does not now rule on those issues. Plaintiff shall make the appropriate administrative application within whatever time period remains available under the statute.

ORDERED:

First, that defendant's counterclaim is GRANTED and defendant is awarded JUDGMENT in the amount of $108,701, but no interest accrued prior to this court's judgment.

Second, post judgment interest shall be allowed to defendant, pursuant to 28 U.S.C. § 1961, at the present rate of 8.57 percent per annum; and

Third, plaintiffs' complaint is DENIED, except to the extent it is determined that the three-year availability period for expenditure of funds awarded under a grantback was tolled during all judicial proceedings, including the instant proceeding.

IT IS SO ORDERED.

DATED: September 3, 1985.

/s/ Edward J. Garcia
JUDGE
UNITED STATES DISTRICT COURT

No. 87-1261

In the Supreme Court of the United States

OCTOBER TERM, 1987

BILL HONIG, SUPERINTENDENT OF PUBLIC INSTRUCTION FOR THE STATE OF CALIFORNIA, ET AL., PETITIONERS

v.

WILLIAM J. BENNETT, SECRETARY OF EDUCATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Secretary of Education is entitled to pre-judgment interest in this case.

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OCTOBER TERM, 1987

No. 87-1261

BILL HONIG, SUPERINTENDENT OF PUBLIC INSTRUCTION FOR THE STATE OF CALIFORNIA, ET AL., PETITIONERS

v.

WILLIAM J. BENNETT, SECRETARY OF EDUCATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 831 F.2d 875. The order of the district court (Pet. App. 10a-13a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 2, 1987. The petition for a writ of certiorari was filed on January 27, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners' debt to the Department of Education[1] arose from the State's misuse of federal monies provided

[1] The Department of Education was created in 1980. See Department of Education Organization Act, 20 U.S.C. 3401 *et seq.* Before that time, the agency was called the Office of Education and its chief

under Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (1976 ed.) 241a *et seq.*[2] Congress created Title I to improve the educational opportunities available to disadvantaged children (20 U.S.C. (1976 ed.) 241a), and authorized the Secretary to provide financial assistance in the form of grants to state educational agencies upon their assurances that the funds would be spent only on programs that comply with all statutory and regulatory requirements (20 U.S.C. (1976 ed.) 241f). States must repay to the Secretary any Title I funds spent in contravention of these requirements. See *Bell* v. *New Jersey*, 461 U.S. 773 (1983).

In 1978, after auditing petitioners' records and providing an administrative hearing, the Secretary determined that petitioner Hayward Unified School District had misspent more than $108,000 in Title I funds between 1970 and 1972 (Pet. App. 4a). After receiving the Secretary's final decision, the State of California filed a petition for review of this decision in the court of appeals (*ibid.*). The court eventually dismissed this petition for lack of jurisdiction.[3] Although the State could have filed a

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administrator was the Commissioner of Education. For simplicity, we use only the current names: The Department of Education and the Secretary of Education.

[2] The statute subsequently was amended and reorganized in the Education Amendments of 1978, 20 U.S.C. 2701 *et seq.* As of July 1, 1982, the Title I program was superseded by Chapter 1 of the Education Consolidation and Improvement Act of 1981, 20 U.S.C. 3801 *et seq.* These later legislative enactments have no bearing on this case. See *Bennett* v. *New Jersey*, 470 U.S. 632, 641 (1985).

[3] An appeal of the Secretary's decision should have been filed in the district court. See *Bell* v. *New Jersey*, 461 U.S. at 777 n.3. The judicial review procedure for this type of audit dispute subsequently was altered by Congress to provide for direct review in the appropriate court of appeals. See 20 U.S.C. 1234d, 2851.

proper petition for review in the district court, it did not do so (*ibid.*).

Almost a year and a half after the State's petition for review was dismissed—and two and a half years after the Secretary's final decision—the Secretary sent the State a letter demanding repayment of the misspent funds (Pet. App. 4a). This letter informed the State that the Secretary would begin to assess interest on the outstanding debt if the State did not satisfy its obligation within 30 days (*ibid.*). The State ignored this request (*ibid.*). After a second letter failed to bring repayment, the Secretary sent a third demand letter, which raised the possibility that the Secretary would obtain repayment by offsetting the State's debt—including the interest that had accrued since April 16, 1981 (30 days after the Secretary's first demand letter)—against current grant funds (*ibid.*).

2. After receiving the Secretary's third demand letter, petitioners filed this action in the district court. They alleged that the Secretary had erroneously concluded that they had misspent the funds in question, and that, in any event, the Secretary could not recover these funds from current grant monies (Pet. App. 4a). The Secretary filed a counterclaim asserting that the United States was entitled to the misspent funds, plus prejudgment interest (*ibid.*). The Secretary did not request interest from the date of the wrongful expenditures (1970-1972) or even from the date he determined that petitioners had misspent Title I funds (1978); rather, he only sought interest from April 16, 1981—30 days after his first formal demand for repayment which had notified the State that interest would accrue if repayment was not made within 30 days (*ibid.*).

The Secretary moved for summary judgment and the district court granted this motion in part (see Pet. App. 11a). The court ruled that petitioners' failure to seek timely judicial review of the Secretary's decision in the proper

court made that decision final and unreviewable; petitioners were therefore bound by the findings of fact and conclusions of law contained in that decision (*ibid.*). The court thus upheld the Secretary's determination that petitioners had misspent $108,701 in Title I funds (*ibid.*). The court further held that the Secretary had both a statutory and a common law right to collect these misspent funds through an administrative offset of current grants (*ibid.*). The court, however, reserved judgment on whether the Secretary was entitled to prejudgment interest (*ibid.*).

The Secretary then filed a motion for summary judgment granting prejudgment interest. The district court ruled that the Secretary could not receive interest for any time prior to its judgment, and denied the motion (Pet. App. 12a). The court interpreted this Court's decision in *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1 (1981), as establishing a constitutional prohibition against imposing any financial liability on a state under a federal grant program except where Congress has expressly set forth the conditions of such liability and the state has accepted them (Pet. App. 12a). Because Title I did not explicitly provide that states must pay interest on delinquent debts, the court concluded that the Secretary could not collect prejudgment interest from petitioners (*ibid.*).[4]

3. The court of appeals reversed the district court's denial of prejudgment interest (Pet. App. 1a-9a).[5] It held that under this Court's recent decision in *West Virginia* v. *United States*, No. 85-937 (Jan. 13, 1987), the Secretary

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[4] The court did allow postjudgment interest pursuant to 28 U.S.C. 1961.

[5] Petitioners did not appeal the district court's affirmance of the Secretary's decision that they had misspent the funds in question, or its decision that the monies could be recovered by an offset against current grant funds.

was entitled to the interest that he sought. Even assuming that petitioners were correct in asserting that *West Virginia* requires a balancing of the interests of the state and federal governments, the court held that in this case "the balance should be weighted in favor of the allowance of [prejudgment] interest" (Pet. App. 5a). The court of appeals also rejected the district court's reading of *Pennhurst*. It held that "[i]t is clear from the Supreme Court's subsequent decision in *Bell v. New Jersey*, 461 U.S. 773 (1983) that *Pennhurst* is not applicable to the State's liability for prejudgment interest" (Pet. App. 8a).

ARGUMENT

The decision of the court of appeals is correct and fully comports with this Court's decisions in *West Virginia* and *Bell* v. *New Jersey*. Further review by this Court accordingly is not warranted.

1. Petitioners assert that the court of appeals erred in applying *West Virginia* to the facts of this case (Pet. 5-7).[6] They suggest that the analysis contained in *West Virginia* is limited to " 'ordinary commercial contract[s]' " (Pet. 5-6 (citation omitted)), and that Title I "requires a different approach * * * than does an arms-length contract involving bricks and mortar or rocks and soil" (*id.* at 7). Petitioners' contention, however, is conclusively rebutted by *West Virginia* itself. The Court there explained (slip op. 4) that the federal rule governing the award of prejudgment interest against a state—which requires a federal court to "consider the interests of the two governments involved"—was first enunciated in *Board of County Commissioners* v. *United States*, 308 U.S. 343, 350 (1939). And in *Board of County Commissioners*, the government's claim against

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[6] Petitioners concede that the Debt Collection Act of 1982, 31 U.S.C. 3701 *et seq.*, has no application to this case (Pet. 7 n.4).

the State did not arise from an " 'ordinary commercial contract[].' " Rather, it arose out of the federal government's efforts to recover state taxes wrongly imposed on Indians. There can thus be no doubt that the general rule applied in *West Virginia* is broad enough to encompass the Secretary's claim for prejudgment interest here.

It is equally clear that the court of appeals correctly assessed the competing concerns of the Secretary and petitioners in concluding that the Secretary is entitled to the prejudgment interest that he seeks.[7] "Prejudgment interest is an element of complete compensation" (*West Virginia,* slip op. 5). Absent such an award, the creditor will not be "compensate[d] for the loss of use of money * * * from the time [his] claim accrues until judgment is entered" (*id.* at 5 n.2). The debtor had the use of the money from the time the debt arose until the judgment was entered. The decision to award prejudgment interest simply recognizes that the debtor should pay for the benefit he has received at the expense of the creditor.[8]

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[7] In the court of appeals, we argued that petitioners had to demonstrate a compelling interest in order to deny the Secretary complete compensation for the monies that they had misspent (Pet. App. 5a). While we still believe that this interpretation of *West Virginia* is correct, we also agree with the court of appeals that this issue need not be addressed in this case, because even an unweighted balancing of the interests of the respective governments requires an award of prejudgment interest.

[8] Prejudgment interest is appropriate here for two other reasons: First, petitioners misspent more than $100,000, as measured in early 1970's dollars. The district court's judgment, which was issued in 1985, measured petitioners' obligation in terms of then current dollars. Denial of prejudgment interest therefore would exacerbate the disadvantage to the federal government resulting from the change in the value of the dollar between 1972 and 1985. Second, without liability for prejudgment interest, debtors such as petitioners would have little incentive to satisfy or otherwise settle meritorious claims against

In sum, as the court of appeals recognized (Pet. App. 6a), "[o]nly an award of prejudgment interest will fully compensate the [Secretary] for the funds wrongfully withheld by [petitioners]. * * * Such an award will serve the purposes of Congress reflected in Title I by insuring that moneys appropriated for use under Title I are devoted to service of the intended beneficiaries—disadvantaged children—rather than to the relief of [petitioners'] taxpayers." Moreover, as the court of appeals recognized (*id.* at 7a), petitioners are "not without fault" in this matter. Instead of promptly pursuing available avenues for judical resolution of this dispute, petitioners simply ignored repeated demands by the Secretary for repayment of the funds. Having chosen this means to enjoy the benefits of not repaying the misspent funds for a number of years, petitioners are in a poor position to seek to place the full cost for their failure to satisfy their debt on the Secretary.[9]

Indeed, the only interest that petitioners advance against these weighty considerations is that if they are required to pay prejudgment interest, they will have less money to spend on their educational system (Pet. 7). But this reflects nothing more than petitioners' desire to "not pay [] any more than [they] ha[ve] to" (*West Virginia*, slip op. 6). Any time a state pays prejudgment interest, there is

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them. In this case, for example, the principal amount due was not paid until July 1986, more than five years after the Secretary submitted his initial demand for payment.

[9] The Secretary did not seek full compensation for the entire time he was deprived of the misspent funds. Instead, he only sought interest from April 16, 1981, a month after the original demand letter. This was nearly two and a half years after he had issued his final administrative determination, and approximately nine years after the funds had been misspent.

necessarily less money to devote to other worthwhile projects. Even where assessment of prejudgment interest "may work a hardship upon the citizens of [the State]" (*id.* at 7), that consideration does not "justify relieving the State of its obligation to compensate the Federal Government fully" for the misspent funds (*id.* at 6).

Petitioners' alternative argument—that the decision below conflicts with *Pennhurst* (Pet. 8-9)—is also without foundation. In *Bell* v. *New Jersey*, 461 U.S. 773, 790 n.17 (1983), this Court explicitly laid to rest the notion that *Pennhurst* limits the remedies available to the Secretary when a state fails to abide by the terms of its Title I grant.[10] Petitioners' suggestion that *Bell* is inapposite because prejudgment interest is a penalty rather than a remedy (Pet. 9), runs directly counter to this Court's recognition of the principle that "interest is an element of complete compensation[:] * * * [it] serves to compensate for the loss of use of money due as damages from the time the claim accrues until judgment is entered, thereby achieving full compensation for the injury those damages are intended to redress" (*West Virginia*, slip op. 5 & n.2).

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[10] In *Arkansas* v. *Block*, 825 F.2d 1254, 1258 n.7 (8th Cir. 1987), a case involving a debt incurred after the effective date of the Debt Collection Act of 1982, the court in a footnote cited the *Pennhurst* analysis as an "alternative rationale [that] also supports our decision." That court, however, like the district court here, overlooked this Court's explanation in *Bell* of the *Pennhurst* analysis.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

CHARLES FRIED
Solicitor General

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